

- > Segment reporting:  
New capital allocation methodology

- > 4<sup>th</sup> Capital Markets Day

- > Bucharest, 9 October 2006

- > Reinhard Ortner, CFO, Erste Bank

## > Agenda

- 1. Rationale**
- 2. New capital allocation methodology**
- 3. Examples**
- 4. Timeline & summary**

## > Capital allocation: performance vs. regulatory view

### » Performance view

- » ROE is important KPI for EB Group and subsidiaries
- » ROE is based on the Group's IFRS average shareholders' equity
- » IFRS shareholders' equity is therefore allocated to business lines for comparable performance indicators across the group

### Characteristics of capital components

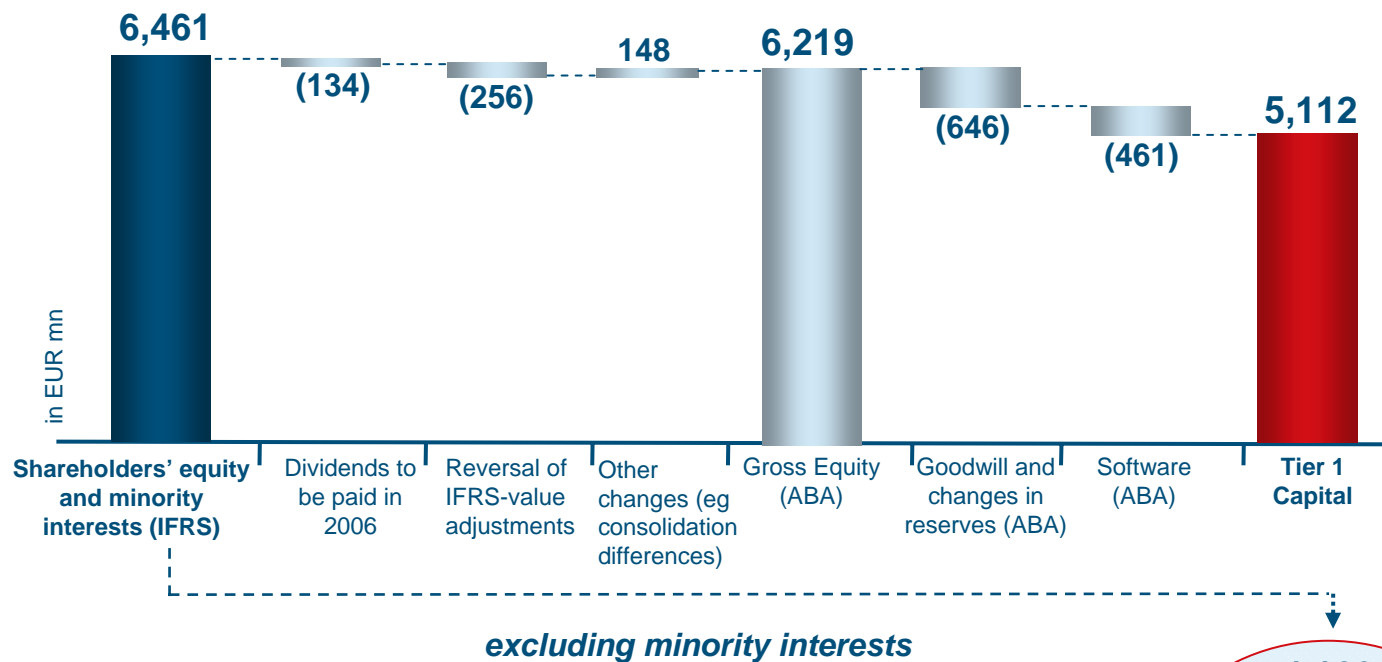
Capital component	Performance view	Regulatory view
Shareholders' equity	Cost of Capital calculated	Capital, adapted, part of Tier 1
Hybrid Tier 1	Margin expense allocated to business	Capital, limited, part of Tier 1
Tier 2	Margin expense allocated to business	Capital, limited, Tier 2
Tier 3	Margin expense allocated to trading book	Capital, limited, Tier 3

### » Regulatory view

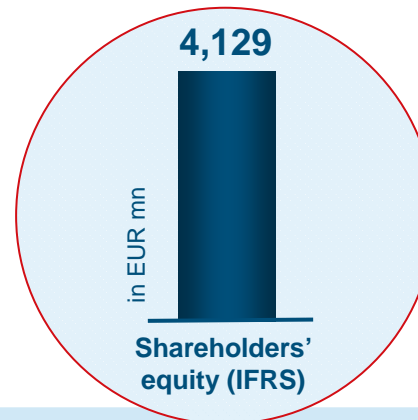
- » Capital defined as all components that can be used to cover unexpected risks
- » In contrast to capital allocation method broadly no differentiation between core capital and other types of hybrid instruments

## > Shareholders' equity vs Tier 1 capital

### Reconciliation of shareholders' equity with Tier 1 capital (2005)



**Application of new capital allocation methodology**

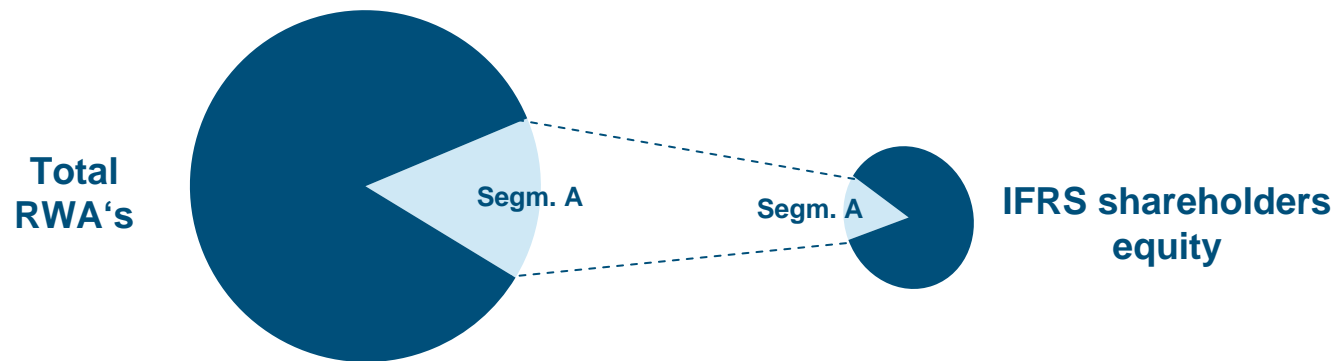


## > Current capital allocation process

### Recap of current methodology

#### » Risk weighted assets as key to group equity allocation

-> Size of segment RWA's determines how much equity is allocated to the segment



#### » Proceeds from local equity included in segment P&L

#### » Acquisition funding costs reflected in segment P&L

## > Why alter capital allocation procedures (now)?

### **Current methodology emphasises investment view**

- » **Treats capital increases differently**
  - » General capital increases allocated evenly to all segments
  - » Acquisition related capital increases are directly allocated to relevant entity (eg CS)
- » **Present capital allocation methodology not fully appropriate for equity capital raisings (-> BCR acquisition)**
- » **Does not reflect internal steering procedures for group-wide implementation of common controlling methodologies (GPM project)**

### **New methodology based on economic capital view**

- » **Focus on efficient capital deployment**
  - » Distribution of shareholders' equity to business lines as part of budgeting process
  - » Ongoing performance measurement in order to ensure efficient capital usage
- » **Leads to fully comparable segment ROE's**
  - » Identical treatment for all segments

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## > Incorporated risk parameters

### **Equity allocation incorporates three main input parameters:**

- » Credit risk: Risk weighted assets based on Basel II calculation rules
- » Market risk: VAR limits for trading book and market risks in banking book
- » Operational risk: EB uses costs as the sole input parameter

-> Correlation effects between risk parameters will be taken into account

### **» Risk parameters are consistent with the Basel II approach**

### **» Parameters will be stable to give longer time comparability**

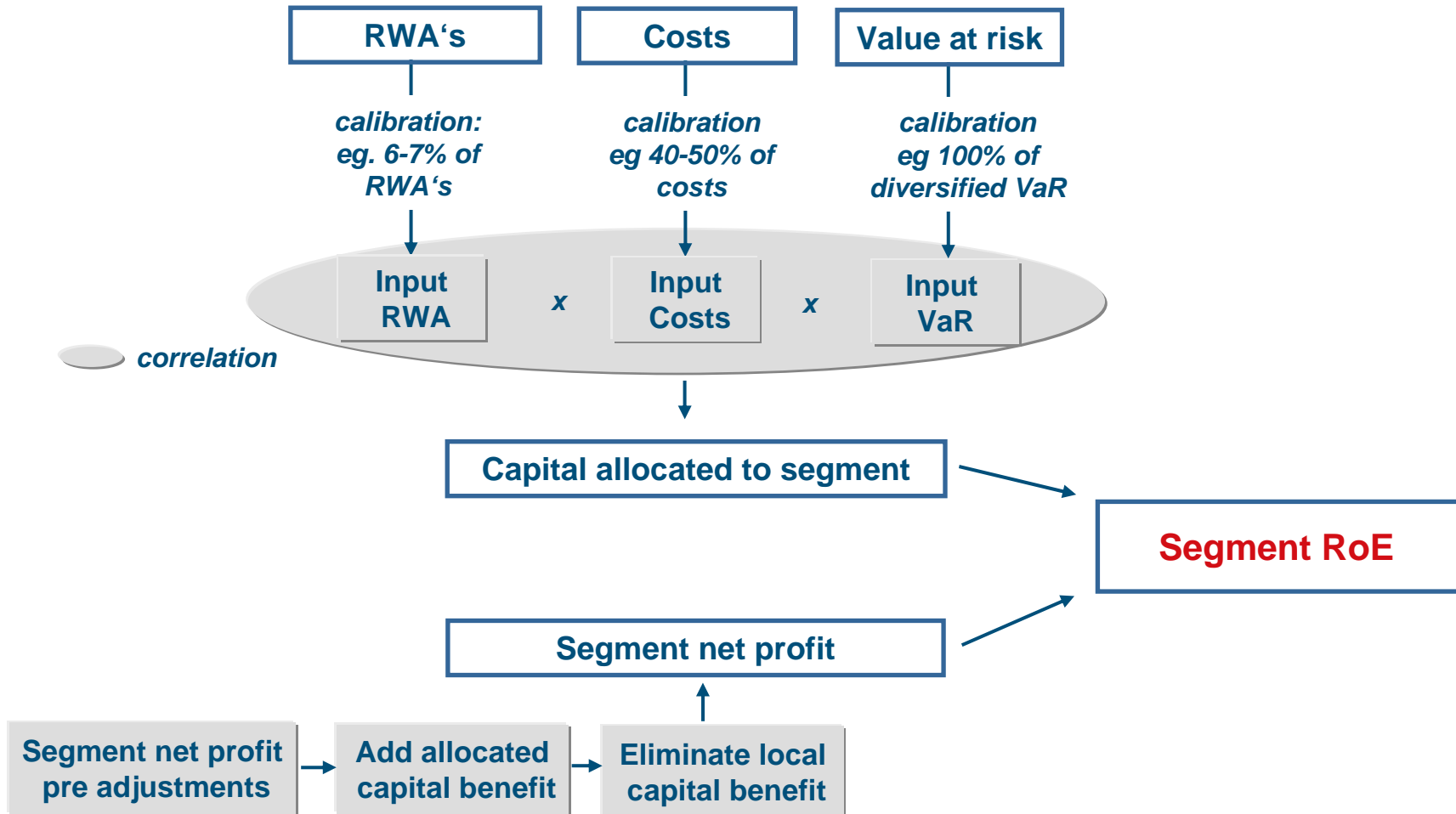
- » As a result, capital allocated to segments will differ from IFRS equity
- » Difference will be shown in Corporate Center

### **» EB equity stake in entities will be taken into account in calculation of parameters**



## > Methodology of new capital allocation process

### New process to allocate equity to segments



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## > Example 1: Segment R&M Austria

In EUR m	R&M Austria				
	H1 06 as reported	Proceeds on local equity	Funding costs	Calculatory interest on new equity	H1 06 restated
Net interest income	257.3	(19.3)	14.1	16.1	268.2
Risk provisions for loans and adv.	(48.9)				(48.9)
Net commission income	174.9				174.9
Net trading result	5.3				5.3
General admin. expenses	(317.7)				(317.7)
Income from insurance business	10.5				10.5
Other operating results	(1.5)				(1.5)
<b>Pre-tax profit</b>	<b>79.9</b>	(19.3)	<b>14.1</b>	<b>16.1</b>	<b>90.8</b>
Taxes on income	(17.4)	4.2	(3.1)	(3.5)	(19.8)
Minority interests	(9.1)				(9.1)
<b>Net profit after minority interests</b>	<b>53.5</b>	<b>(15.1)</b>	<b>11.0</b>	<b>12.6</b>	<b>62.0</b>
Average risk-weighted assets	13,013.1				13,013.1
Average attributed equity	951.7				857.7
<b>Cost/income ratio</b>	<b>70.9%</b>				<b>69.2%</b>
<b>ROE on net profit after minorities</b>	<b>11.2%</b>				<b>14.5%</b>
Thereof funding costs	(14.1)				0.0

## > Example 2: Segment Hungary

In EUR m	Hungary				
	H1 06 as reported	Proceeds on local equity	Funding costs	Calculatory interest on new equity	H1 06 restated
Net interest income	109.8	(6.2)	9.4	4.8	117.9
Risk provisions for loans and adv.	(14.1)				(14.1)
Net commission income	31.9				31.9
Net trading result	17.5				17.5
General admin. expenses	(93.4)				(93.4)
Income from insurance business	0.0				0.0
Other operating results	(9.1)				(9.1)
<b>Pre-tax profit</b>	<b>42.6</b>	(6.2)	<b>9.4</b>	<b>4.8</b>	<b>50.7</b>
Taxes on income	(8.9)	1.4	(2.1)	(1.1)	(10.7)
Minority interests	(0.1)				(0.1)
<b>Net profit after minority interests</b>	<b>33.6</b>	<b>(4.8)</b>	<b>7.3</b>	<b>3.8</b>	<b>39.9</b>
Average risk-weighted assets	3,630.9				3,630.9
Average attributed equity	265.5				257.9
<b>Cost/income ratio</b>	<b>58.7%</b>				<b>55.8%</b>
<b>ROE on net profit after minorities</b>	<b>25.3%</b>				<b>30.9%</b>
Thereof funding costs	(9.4)				0.0

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## > Timeline & summary

### **First time implementation in segment reporting with Q4 2006**

- » **BCR will be included as segment in Q4 (pending closing)**
- » **New Capital Allocation Methodology will be applied**
- » **Q4 2006 and restated results of previous quarters results will be based on Basel I rules for RWA**
  - » Restated segment data will be available on our website in December 2006
- » **Basel II rules will apply to RWA calculation from Q1 2007**
  - » Basel II impact will be clearly visible on segment level

### **Summary: new methodology enables full segment comparability**

- » **Harmonisation of business definitions achieved through GPM project allows group-wide comparability of business lines**
- » **New methodology enables a transparent, performance linked capital allocation (cornerstone of GPM)**
- » **Cost of Capital for RWA is charged**
  - » Integrated in transaction pricing system throughout Erste Bank Group